



Section 7: VITA's Financial Model

Internal Service Fund Model

During the spring of 2003, the VITA Transition Team invested significant effort in researching and evaluating financial models for the new agency, consistent with the Value Proposition outlined in Section 2. After reviewing business practices in technology service organizations in both the public and private sector, the Internal Service Fund model was chosen for VITA for a number of reasons. Specifically, the ISF approach provides the following benefits:

- *ISFs more closely model private sector "business best practices".* The rendering of detailed bills to each customer promotes informed economic decision making by customers.
- ISF creates checks and balances since agencies are billed for services rendered. Agencies must be prudent with respect to the services they request, since they must pay for these services.
- There are *virtually no limits on capacity and availability of services*. As long as a customer is willing to pay for a service, it will be rendered.
- Service Level Agreements (SLA's) work under the ISF because they are not subject to a specific funding stream (e.g. general funds).
- The model is approved by the federal government and *does not place the Commonwealth in financial jeopardy in subsequent audits*.
- The ISF model has been subjected to numerous state and federal audits and has emerged unscathed. From a federal audit perspective, the Commonwealth is one of the few states that does cost allocation correctly.
- ISF funding *ensures maximum use of federal funds*.
- Local governments may participate under VITA's federally approved cost methodology.
- Split-funded applications and projects are not problematic.

Likely Exceptions to ISF Model

In theory, any service can be provided through an internal service fund. However, exceptions are possible for services that are traditionally funded through central appropriations.

Although a final determination has not been made at this time, likely candidates for central funding would include those functions that are of an oversight nature or where funding has not been provided to individual agencies. An example of oversight activities would be the VITA Project Management Division.

Transfers of Existing Equipment

It is VITA's responsibility to consolidate the IT servers, PCs, routers, networks, and other operational aspects for the Commonwealth's Executive Branch agencies. VITA is required to manage and control the IT assets associated with providing IT service. VITA's policy for transferring assets is as follows:

- VITA will manage all IT assets that are "in service".
- In-service IT assets are transferred, inventoried and tracked by VITA. Agencies will assist VITA in tracking IT assets.
- For all IT assets transferred to VITA, the value of the asset will be determined based on available information (purchase date, purchase price, and expected useful life).
- Agencies, regardless of funding source, will likely be provided with a one-time credit for transferred assets on their VITA services bill equal to the residual value of the assets transferred.
- VITA assumes responsibility for any leases or maintenance contracts on transferred assets as of the effective date of the transfer. Software licenses and maintenance contracts are considered IT assets.
- VITA will not require a transfer of funds for maintenance or leases from the agencies, since VITA services fees will include associated maintenance and acquisition costs.
- PCs that are in-service may be placed on seat-management service or break-fix service through VITA.

Current/Planned Internal Service Funds

The three internal service funds identified in the Appropriations Act--Computer Operations Services, Information Systems Development Services, and Integrated Voice, Data, and Video Communications Services--will be used to fund nearly all VITA activities. No other internal service funds are anticipated at this time because virtually unlimited individual services can be identified and accounted for separately within the existing funds.

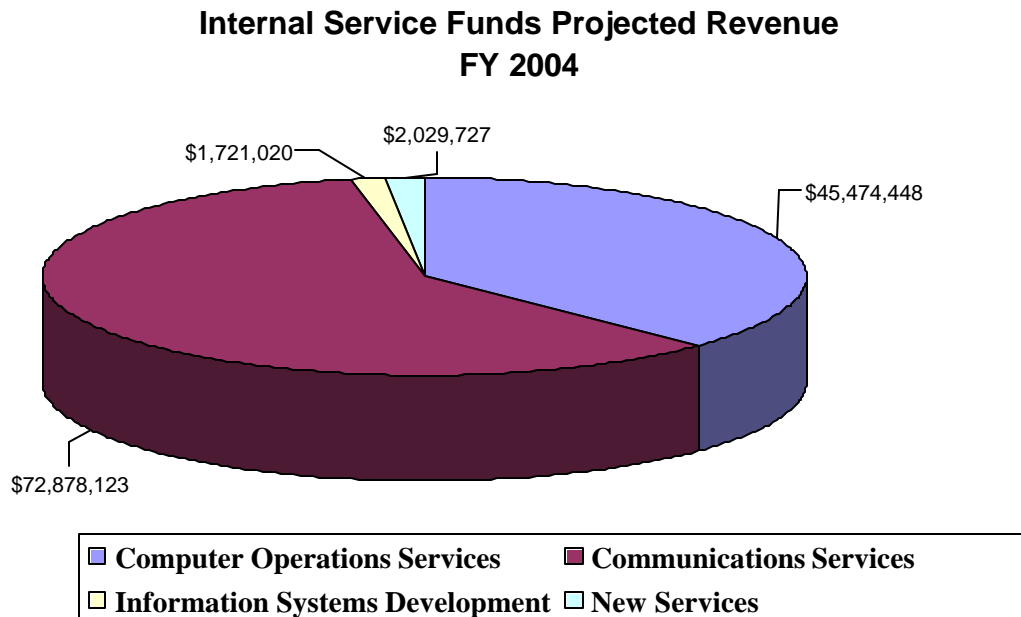
VITA's pricing strategies will be similar to those currently in use. We will use standard pricing based on the best data available and request approval by the Joint Legislative Audit and Review Commission of these "interim rates" in October 2003. As the complete cost picture becomes available (during the first 18 months of the new VITA organization), VITA will adjust its rate structure to actual cost keeping in mind the need to be competitive with private sector offerings.

Schedule of Rates and Charges

The Appropriation Act requires that the Joint Legislative Audit and Review Commission (JLARC) approve the schedule of rates and charges for VITA services. Appendix 7-1 contains JLARC approved rates and charges for VITA's three internal service funds. Rates are generally rendered for services that VITA staff provides. Surcharges are utilized for vendor-supplied services that are surcharged to cover the cost of administration.

Estimated Revenues by Internal Service Fund

VITA's three internal service funds revenues are projected to be \$122.1 million in FY 2004. As the chart below illustrates, the majority of these funds (almost 60%) will come from Communications Services, with another 37% provided via Computer Operations Services. Appendix 7-2 outlines estimated revenue by internal service fund for FY 2004, with a special designation for new services to be provided by VITA as a result of IT consolidation. These revenues are further broken down in the appendix into major service areas within each of these funds.



Other Sources of Revenue

The Appropriations Act Section 510.10 identifies \$13,985,906 in "start-up" costs for VITA. These funds are proposed be expended as follows (see Section 4 for further details on projects):

- \$3,700,000 to hold harmless small and medium agencies for FY 04 IT savings deducted from their budgets in the 2003 Appropriation Act (see further explanation below)
- \$2,800,000 for the Cisco Information Center
- \$2,000,000 for the Customer Care Center
- \$2,400,000 for Network Security
- \$3,086,000 for server consolidation, consultants, & desktop services

The Industrial Funding Adjustment (IFA), wherein private sector partners holding statewide contracts pay a percentage of revenues to cover the costs of VITA-provided acquisition services, is expected to provide \$2,000,000 in FY2004.

VITA also receives general and special fund appropriations. In FY 2004, general funds provide \$2,344,445 for information systems management and strategic direction. Special fund appropriations, in the amount of \$34,363,680, are provided for emergency communications management and direction and public information access services.

Projected Expenses by Fund and Directorate

For FY 2004, VITA has estimated expenses of \$121.7 million for its internal service funds and \$36.7 million for its general and special funds. Appendix 7-3 provides a breakdown by directorate. Revenues are expected to exceed expenses by \$0.4 million in FY 2004. Increased expenses associated with consolidation efforts that occur over the remaining FY 2004 period will be absorbed through available fund balances.

Pending final approval by the Department of Planning and Budget, none of the \$14 million in VITA start-up costs discussed above has been included in projected revenues or expenses.

FY 2004 IT Transformation Savings Gap

The Due Diligence effort conducted by BearingPoint Inc. in the fall of 2002 served as the basis for calculating the estimated \$37.4 million in savings associated with agency consolidation that was included in the 2003 Appropriation Act. BearingPoint's savings calculations relied heavily on an aggressive consolidation schedule, and also assumed the ability to reduce staffing complements where economically justified.

The VITA legislation passed by the General Assembly calls for an 18-month phase-in of the new agency that significantly alters the pace of IT infrastructure consolidation. The Governor has also committed that the creation of VITA will not result in net layoffs. Accordingly, while pro-rata budget reductions for in-scope agencies remain in the Appropriation Act, the \$37.4 million in originally estimated savings will not occur in FY 2004.

The Secretaries of Technology and Finance, in conjunction with the Governor's Office, have committed to work to minimize the impact of these reductions. Out of the \$14 million provided to VITA for FY 2004 start-up costs, VITA has committed \$3.7 million to "make whole" small and medium size agencies for FY 2004. The Secretaries continue to work with the administration to address the reductions to large agencies.

Savings Documentation Methodology

VITA is developing a cost savings tracking tool that will document savings initiatives, assign responsibility, provide target savings amounts, and document savings achieved. The tool will also identify where the savings occur: within VITA or within another state agency. We are working with the Secretary of Finance on an agreeable distribution of savings that occur in other agencies in order to fund the Virginia Information Technology Fund.